SOUTHWEST GAS COMPANY

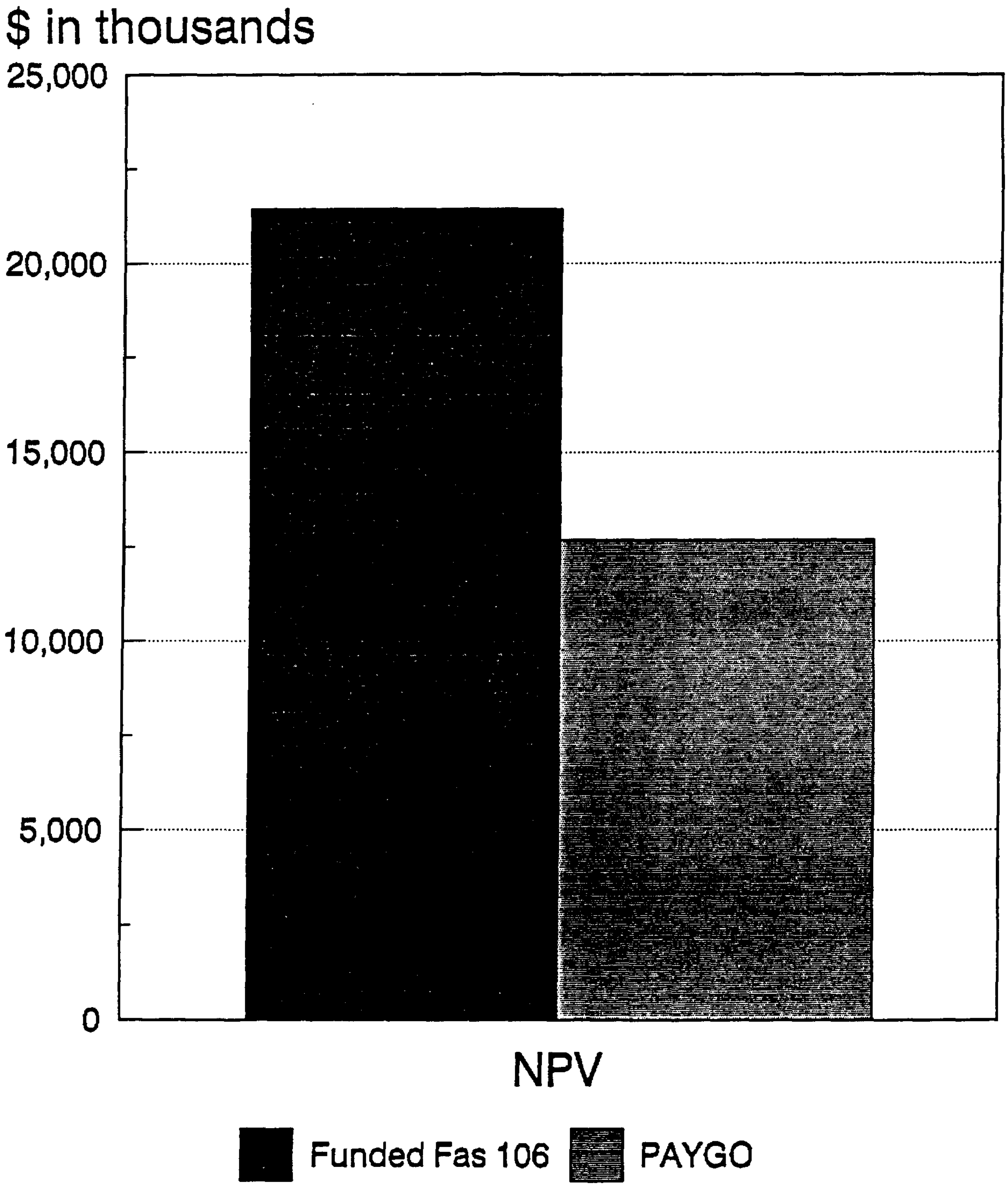
Postretirement Benefits Other than Pensions
($ in thousands)

	Year	Funded FAS 106 Expense ($000)	PAYG Expense ($000)
	1991	2,849	676
	1992	2,824	772
	1993	2,759	890
	1994	2,672	1,025
	1995	2,615	1,171
	1996	2,560	1,304
	1997	2,507	1,408
	1998	2,446	1,486
	1999	2,350	1,652
	2000	2,284	1,797
	2001	2,225	1,927
	2002	2,167	2,057
	2003	2,077	2,189
	2004	1,991	2,313
	2005	1,928	2,472
	2006	1,864	2,567
	2007	1,804	2,721
	2008	1,733	2,871
	2009	1,604	3,052
	2010	1,545	3,204
@NPV	0.00%	44,804	37,554
	9.00%	24,157	15,118
	11.26%	21,462	12,685

Based on DR # SWG-17, Q.1

SOUTHWEST GAS COMPANY

Postretirement Benefits other than Pensions
Net Present Value at 11.26%



APPENDIX 4B

Respondent Utilities' Comparisons

of

Prefunding to Pay-As-You-Go

FASB NO. 106 - RETIREE HEALTH CARE ACCOUNTING
EARLY ADOPTERS AND FOOTNOTE DISCLOSURES REVIEWED

Most companies currently account for retirement benefits (except pensions) on a "pay-as-you-go" basis. As claims are made, they expense and disclose the amount. FASB Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," requires the expected cost of these benefits (primarily retiree medical) to be accrued. The liability is recorded during the years the employee works using the familiar pension accounting model. However, unlike pensions, other retirement benefits are rarely funded. Thus, adopting FASB No. 106 will create a significant unfunded liability for many companies as well as negative impacts on income (ACCOUNTING ISSUES, January 2, 1991).

Early Adopters

The FASB has given companies until 1993 to adopt Statement No. 106, but a few managements have elected to adopt the new methodology early. **Tables 1A and 1B** below give the impacts for six of these companies. Table 1A lists the unfunded liability, the immediate after-tax earnings charge and the percentage impact on shareholders' equity. Table 1B compares the FASB No. 106 expense to the company's previous charge and relates the increase to pre-tax income.

TABLE 1A

COMPANIES THAT HAVE ADOPTED FASB NO. 106 METHODOLOGY
Balance Sheet Impact
($ millions)

(1) Company	(2) Industry	(3) Year Adopted	(4) Unfunded Obligation	(5) Immediate Earnings Charge	(6) Charge as a Percent of Equity	(7) Liability as a Multiple of Pay-As-You-Go Expense
Abbott Labs	Health Care	1991	$ 214 (a)	$ 128	5%	n/a
Dayton Hudson	Specialty Stores	1990	80 (a)	48	3%	20
First Empire State	Banking	1989	16	9	2%	16
General Mills	Food	1989	116	70	11%	23
IBM	Computers	1991	3,767 (a)	2,260	5%	39
LTV	Steel	1988	2,363	2,263	(b)	22

Notes:
n/a: Not available
(a) Estimated by dividing after-tax earnings charge by one minus an assumed 40% tax rate.
(b) Equity was negative prior to charge.

When FASB No. 106 is adopted, the unfunded liability (Table 1A, Column 4) may be recorded in the balance sheet by taking a one-time charge to earnings. Alternatively, management has the option of recording the liability over twenty years. All of the companies in Table 1A elected to take a one-time charge to earnings (Column 5). Three of the companies (**Abbott Labs, Dayton Hudson**, and **General Mills**) conveniently had nonrecurring gains in the same period so that reported net income and equity was unaffected.

The $2.3 billion after-tax charge taken by IBM (Table 1A, Column 5) represents the after-tax cost of establishing the liability for IBM's **active** employees only. Prior to the adoption of Statement No. 106, IBM followed a policy known as "terminal accrual". Under "terminal accrual", the entire future cost of providing benefits, other than pensions, is recorded when an employee retirees. Thus, IBM had previously recorded the liability for retired workers' benefits.

TABLE 1B

COMPANIES THAT HAVE ADOPTED FASB NO. 106 METHODOLOGY
Impact on Expense
($ millions)

(1) Company	(2) Industry	(3) Year Adopted	(4) Pay-As-You-Go Expense		(5) FASB No. 106 Expense	(6) Percent Increase in Expense	(7) Pre-Tax Income		(8) Percent Decrease in Pre-Tax Income
First Empire State	Banking	1989	$ 1		n/a	n/m	$ 76		n/m
General Mills	Food	1989	5		12	126%	518	(d)	1%
IBM	Computers	1991	96	(b,c)	n/a	n/a	10,203	(b)	n/m
LTV	Steel	1988	107		239	124%	(865)		n/a

Notes:

n/a: Not available

n/m: Not material

(b) Adopted in the first quarter of 1991, amount given is for year preceding adoption.

(c) Unlike most companies that currently use "pay-as-you-go" accounting for retiree medical cost, this company used a method which fully accrued the cost of retiree medical benefits at the employees' retirement date.

(d) Continuing operations

As shown in Table 1B, LTV's annual retiree health care expense (Column 5) is more than twice the "pay-as-you-go" amount (Column 4). For General Mills, doubling the expense reduces pre-tax income by 1%. **First Empire State** had no material change in its annual retiree health care expense. **Abbott Labs** and IBM did not provide information about the increase in expense but IBM disclosed that the impact on future earnings would be immaterial.

FASB No. 106 Impacts Disclosed

When a new accounting pronouncement is issued, if it has not been implemented, the SEC requires companies to discuss the potential impacts of the required change. Frequently, the disclosure is "boiler plate", briefly describing the new requirements and indicating the general direction of the income statement or balance sheet impact or both.

Tables 2A and 2B include nine companies that had the fortitude to quantify the expected impacts oi the accounting change in their 1990 annual reports.

TABLE 2A

COMPANIES DISCLOSING FASB NO. 106 EFFECT
Potential Balance Sheet Impact
($ millions)

(1) Company	(2) Industry	(3) Unfunded Obligation	(4) "One Time" Charge to Earnings	(5) Charge as a Percent of Equity	(6) Liability as a Multiple of Pay-As-You-Go Expense
AMR	Airline	$ 700	$ 420 (a)	11%	26
ALCOA	Aluminum	1,000	600 (a)	12%	19
Dominion Resources	Elec. Utility	340	204 (a)	6%	38
GE	Diversified	4,200(b)	1,620 (a)	7%	17
Honeywell	Computers	230	138 (a)	8%	n/a
Lockheed	Aerospace	1,000	660	29%	23
United Technologies	Aerospace	500 to 600	300 to 360 (a)	6% to 7%	n/a
USX	Steel/Oil	2,000 to 3,000	1,200 to 1,800 (a)	20% to 30%	13 to 20

Notes:
n/a: not available
(a) Estimated by multiplying unfunded obligation by one minus an assumed 40% tax rate.
(b) See discussion below.

Table 2A (column 3) shows the disclosed unfunded liability. Management has the option of spreading this liability over 20 years. Alternatively, if management elects to recognize the liability immediately, the "one time" charge to earnings is estimated in column 4.

General Electric currently accrues the cost of retirement benefits other than pensions on the employee's retirement date (the same policy followed by IBM before it adopted Statement No. 106). GE has even funded some of the accrued amount. Thus, GE's unfunded and unrecorded obligation for retirement benefits of current workers is $2.7 billion computed as follows:

	$4.2 billion obligation for retired and current employees
Less:	1.5 billion recorded liabilities and assets held in trust for retired workers
	$2.7 billion transition obligation for current workers

TABLE 2B

COMPANIES DISCLOSING FASB NO. 106 EFFECT
Potential Impact on Expense
($ millions)

(1) Company	(2) Industry	(3) Pay-As-You-Go Expense	(4) Estimated FASB No. 106 Expense	(5) Percent Increase in Expense	(6) Pre-Tax Income	(7) Percent Decrease in Pre-Tax Income
AMR	Airline	$ 27	$108 to $136	300% to 400%	$ (33)	n/a
ALCOA	Aluminum	53	n/a	"substantial"	1,047	n/a
American Brands	Tobacco	10	30 to 40	200% to 300%	1,048	2% to 3%
Dominion Resources	Elec. Utility	9	54	500%	642	n/m
Lockheed	Aerospace	43	86 (c)	100%	430	n/m
United Technologies	Aerospace	n/m	n/a	n/a	1,230	n/a
USX	Steel/Oil	150	317 to 483	111% to 222%	1,216	14% to 27%

Notes:
n/a: Not available
n/m: Not material
(c) See discussion below.

Table 2B lists the disclosed "pay-as-you-go" expense (column 3), the estimated expense under Statement No. 106 when provided (column 4), the percent increase in the expense (column 5) and the impact on pre-tax income on a recurring basis (column 7).

Cash Flow Unchanged

Despite the potentially large liabilities and significant expense increases, rating agencies indicate that they will continue to monitor companies' annual cash expenditures for retiree medical. Companies' cash flows are unchanged by the new FASB rule. Since there is no ERISA-like legislation governing post-retirement health benefits, companies are not required to put money aside in a fund to pay for ✓

these future benefits. In addition, there are few tax incentives to do so (ACCOUNTING ISSUES, January 2, 1991). There is no indication that this will change. Retirees receiving health care benefits from corporations are also generally receiving pensions protected by ERISA and guaranteed by the PBGC. There is little support in Washington for legislation that will protect additional benefits of a segment of the elderly population that is better off than those receiving no benefits at all.

Now for the Good News - Companies That Will Be Unaffected

Some companies, while not quantifying the impacts, disclosed that adoption of FASB No. 106 will not impact them materially. **Table 3** lists some of these lucky ones.

Table 3

Companies Not Materially Impacted by FASB No. 106

BankAmerica	Banking
Barnett Bank	Banking
Colgate	Household Products
CoreStates Financial	Banking
Dominion Resources	Electric Utility
First Chicago	Banking
Harsco	Steel Recovery
Lockheed	Aerospace
Martin Marietta	Aerospace
NBD Bancorp	Saving Bank
Philips Petroleum	Oil
Pinnacle West	Electric Utility
Tultex	Sportswear Manufacturer

About half the companies listed in Table 3 are financial institutions, but generalizations may be dangerous. **U.S. Bancorp**, for example, disclosed that it expects the accounting change "to be material to operations".

The reasons these companies will be unaffected by FASB No. 106 are disparate. For example, **Philips Petroleum** explains that "essentially retirees pay their own way" while **Colgate** "intends to utilize a portion of its leveraged ESOP to reduce its current and future obligation." **Lockheed, Martin Marietta, Dominion Resources** and **Pinnacle West** plan to pass the increased cost on to their customers.

Public Utilities - Increased Receivables Rather Than Increased Expense

Dominion Resources discloses in its 1990 annual report that

> [a] transition obligation of approximately $340 million would result from the application of this standard. The transition obligation would be amortized over a 20-year period ... [A]pplication of this Standard in 1993 will increase annual expenses by approximately **six times** the current pay-as-you go amount (emphasis added).

However, rather than the increased cost reducing the bottom line it will be recorded as a receivable.

The FASB allows rate regulated enterprises like Dominion and **Pinnacle West** to capitalize rather than expense a cost if it is probable that the cost will be recovered through rates in the future. The Statement No. 106 expense in excess of amounts currently collected will be recorded as a receivable representing the amount to be collected in the future through rate increases.

Pinnacle West explains:

> Accordingly, this statement should not have a significant impact on Pinnacle West's financial position or results of operations...[since] management expects that most of the increased benefits expense will either be recovered currently through APS rates or that a regulatory asset will be recorded to reflect amounts to be recovered through rates in the future as the costs are paid.

Most utilities should be in a similar position.

Government Contractors - Guess Who Absorbs the Higher Cost?

Table 2A shows that **Lockheed** expects its obligation under FASB No. 106 to be $1 billion. The change in accounting will also double Lockheed's annual expense for retirement benefits other than pensions from $43 million to approximately $86 million (Table 2B) but Lockheed concludes that this "should not have a meaningful impact on reported income on a recurring basis." Lockheed intends to annually fund an amount approximately equal to the FASB No. 106 expense. This will allow Lockheed to include the cost in government contracts.

Martin Marietta, another defense contractor, also plans to pass the increased cost on to the government. Its 1990 annual report explains that

> ... reported annual cost (under Statement No. 106) is expected to be significantly greater than current claims-paid method outlays....[A]n accrual method also is allowable under U.S. Government Cost Accounting Standards, and hence, [Martin Marietta has] elected to use accrual accounting in pricing work to be performed in 1993 and thereafter.

Martin Marietta concludes that "[a]doption is not expected to have a material effect upon reported earnings."

The List of Early Adopters Will Stay Short

Many 1990 annual reports indicate management is undecided about how and when to adopt but some, such as **Eastman Kodak, Union Carbide** and **Goodyear**, say they will wait until 1993.

The list of companies electing to adopt FASB No. 106 before January 1, 1993, the effective date for calendar year companies, is not likely to grow significantly. Some managements simply need the time to accumulate the data required for the calculation. Others are using the time to restructure their retiree medical plans, shifting more of the cost to the retiree, thus lowering the companies' obligation. Still others remember that the effective date of another unpopular pronouncement on accounting for taxes, has been delayed several times. They are keeping their fingers crossed that history will repeat itself. Early adopters are likely to be companies with nonrecurring gains to soften the impact or those already having a bad year and trying to get all the negative news behind them.

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January 2, 1991 INVESTMENT RESEARCH

ACCOUNTING ISSUES

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FASB ACCOUNTING FOR RETIREE HEALTH CARE: A NEW YEAR'S HEADACHE FOR COMPANIES AND ANALYSTS

After eleven years of deliberation, the FASB has issued a standard changing the accounting for retirement benefits such as health care. Most companies now account for these benefits on a "pay as you go" basis. The FASB requires that the expected cost of these benefits be accrued and the obligation recognized over the years the employee works using the familiar pension accounting model. However, unlike pensions, other retirement benefits are rarely funded; the initial and future impacts of the new rule on income and the balance sheet will usually be negative. Companies must adopt the new accounting for calendar year 1993 but may do so sooner. This ACCOUNTING ISSUES explains the major points in the Statement and reviews the basics of retiree health care accounting.

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**FASB ACCOUNTING FOR RETIREE HEALTH CARE:
A NEW YEAR'S HEADACHE FOR COMPANIES AND ANALYSTS**

FASB Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," covers all retirement benefits (expect pensions) expected to be provided to current and future retirees including health care, life insurance, tuition assistance, and legal services. This **ACCOUNTING ISSUES** concentrates on its application to retiree health care since it is the most significant of these benefits. Other retirement benefits will be accounted for in substantially the same way as medical care.

Published estimates of the aggregate retiree health care liability created by this new FASB Statement are horrific. They are frequently accompanied by predictions of plunging corporate profits and other catastrophic impacts on financial statements. However, they usually omit the wildly hypothetical nature of the computation. In **ACCOUNTING ISSUES** March 3, 1988 we referred to the fuss over this FASB project as "Much Ado About Nothing." We continue to believe that predictions of financial disaster as a result of the new accounting are overdone. Rating agencies indicate they will continue to monitor companies' annual cash expenditures for retiree medical. Companies' cash flows are unchanged by the new rule. Also, it is likely that the rule will be modified before it becomes effective.

Key Points

- Reported expense will increase for everyone that offers these benefits. Most companies now account for these benefits by charging current cash payments to expense.
- Retiree health care obligations are generally unfunded.
- Companies have the option of recording the unfunded liability at the date they adopt the new Standard or amortizing it onto the balance sheet over 20 years.
- Companies electing to record the entire liability initially will have a corresponding reduction in earnings and equity.
- There is no cash flow impact from this accounting change. Most companies will continue to fund retiree health care on a "pay-as-you-go" basis unless tax laws are changed.
- The health care liability and expense can vary significantly depending on management's assumptions.
- A company specific health care cost trend rate will be used to project the future costs of the promised benefits.
- The discount rate will be the same as used for pension accounting. It is the rate on high-quality, fixed income investments **currently available**, whose maturities match the expected timing of benefit payments.
- The assumed rate of return on plan assets, if assets exist, will also be the same as used for pension accounting. The rate will reflect the average rate of earnings expected over the long-term.

- Gains and losses created by changes in assumptions must be recognized only if they cumulatively exceed 10% of plan assets or liabilities, just like pensions.
- The new Standard is effective for years starting after December 15, 1992; calendar 1993 for most companies. Companies may adopt sooner, if they choose to. There is a good chance the effective date may slip farther into the future.

How Companies Account Now

Approximately 80% of large companies provide retiree health care benefits. Until FASB No. 106 was issued, there was no specific required accounting.

Most companies that provide benefits account for them on a "pay-as-you-go" basis. As claims are made they expense and disclose the amount.

A few companies accrue the entire future cost on the retirement date. Companies following this policy, known as "terminal accrual", have already recorded the liability to retired employees. When the new FASB rule is adopted, they will need to account for the retirement health care obligation to current workers as well. Companies following this policy include **Corning Glass Works (GLW), General Electric (GE) and IBM.**

Some companies already follow a method that is the same or similar to that being required by the FASB. They accrue an expense and record a liability for retiree medical costs during the period of active employment. Except for some fine tuning, the new FASB rule should have little impact on companies in this category which include:

Commonwealth Edison (CES)
ConAgra (CAG)
Data General (DGN)
Dayton Hudson (DH)
General Mills (GIS)
LTV (QLTV)
Minnesota Mining and Manufacturing (MMM)
The Southern Company (SO)

The following note, taken from LTV's 1989 annual report, illustrates the disclosure that will accompany the new accounting treatment. Except for a few sentences related specifically to LTV's bankruptcy, the information provided is standard.

ILLUSTRATION OF POSTRETIREMENT BENEFIT DISCLOSURE
LTV 1989 ANNUAL REPORT

Employee Compensation and Benefits

Postemployment Health Care and Other Insurance Benefits

Effective January 1, 1988, the Company changed its method of accounting for postemployment health care and other insurance benefits, to a method which accrues these benefits over the period in which active employees become eligible for such postemployment benefits. Previously, such costs were generally expensed as incurred by retirees. The Company believes this accrual method is preferable because it recognizes retiree health care and other insurance benefits, under current benefit plans, on an accrual basis as earned by the employees during their active service.

At January 1, 1988, the actuarial present value of the accumulated benefit obligation for postemployment health care and other insurance benefits was $2,363 million. Approximately $89 million of the January 1, 1988 liability had been recorded previously in conjunction with idlings or shutdowns of facilities. The change in accounting for these postemployment benefits resulted in an additional noncash expense in 1988 of $2,395 million ($23.26 per fully diluted share), including a charge as of January 1, 1988, of $2,263 million (net of a related tax benefit of $11 million) for the cumulative effect adjustment. In addition to the one-time cumulative effect adjustment, 1989 and 1988 expense includes an incremental higher expense of $126 million and $132 million, respectively, as a result of having adopted this new method. Pro forma results for the years ended December 31, 1988 and 1987 are shown on the Consolidated Statement of Operations.

The cumulative effect adjustment recognizes the unfunded present value of the accumulated benefit obligation for retirees and an obligation for the prior services of currently active employees. Because LTV is operating under Chapter 11, it was determined that the aggregate liability for the cumulative effect adjustment at January 1, 1988, should recognize all of the pre-Chapter 11 effects of actuarial gains and losses and any plan amendments applicable to these benefits.

The accumulated benefit obligation was determined using the unit credit method, an assumed health care cost trend rate of 17.0% in 1988 and 14.0% in 1989, declining to 6.8% in the year 2002 and thereafter over the projected payout period of the benefits, and an assumed discount rate of 8.5%. The weighted average health care co-- trend rate over the projected payout period used is 9.0%.

A summary of the components of expense for 1989 and 1988 for these postemployment insurance benefits is as follows (in millions):

	1989	1988
Service cost-benefits earned during the year	$ 48.8	$ 42.6
Imputed interest cost on accumulated benefit obligation	199.5	196.2
Total expense (excluding cumulative effect adjustment in 1988)	$ 248.3	$ 238.8

The actuarial and recorded liabilities for these postemployment insurance benefits, which are unfunded, are as follows (in millions):

	December 31, 1989	1988
Actuarial liability:		
Retirees	$2,029.8	$1,747.4
Active employees currently eligible for benefits	199.1	208.5
Other active employees	555.5	536.1
Total	2,784.4	2,492.0
Unrecognized net actuarial gains (losses)	(211.7)	—
Recorded liability included on the balance sheet	2,572.7	2,492.0
Less current portion of recorded liability	132.0	124.4
Noncurrent recorded liability for postemployment health care and other insurance benefits	$2,440.7	$2,367.6

The actuarial and recorded liabilities for postemployment insurance benefits were reduced by $33 million during 1989 as a result of the sale of the bar division. The actuarial liability for postemployment insurance benefits at December 31, 1989 reflects the repeal in December 1989 of the Medicare Catastrophic Coverage Act. Such repeal, generally effective January 1, 1990, results in a change in assumption on which the liability was determined.

The effect on the present value of the accumulated benefit obligation at January 1, 1989 of a change in each year of one percent upwards or downwards in the health care cost trend rate used would result in an increase of $337 million or a decrease of $278 million in the obligation, respectively. Correspondingly, a change of one percent upwards or downwards in the health care cost trend rate would have resulted in an increase or decrease in 1989 expense of $40 million or $32 million, respectively.

Cash payments made by the Company for these benefits totaled $124 million, $117 million and $116 million in 1989, 1988 and 1987, respectively.

A Review of Retiree Health Care Accounting

The FASB concluded that retiree health benefits, like pensions, are a form of deferred compensation. Consequently, the new accounting follows the now familiar FASB No. 87 pension model. In contrast to the generally favorable consequences that followed adoption of FASB No. 87, the initial and future impacts of FASB No. 106 on income and the balance sheet will usually be negative.

Pension obligations are usually well funded. Any "unfunded" liability in the balance sheet under FASB No. 87 is usually small. Similarly, the income on pension funds tends to be large and to offset the annual expense in the income statement. Funded retirement health plans are rare, except in public utilities. Thus, the gains that occurred when new pension accounting was applied will not be repeated with Statement 106.

The basic steps in retirement health benefit accounting are:

1. Estimate the future payments to be made to or for employees during their retirement.

2. Determine the present value of those payments.

3. Allocate the present value as expense and recognize a liability during the employee's working career.

4. To the extent that the company has not adequately provided for these benefits in prior years (Step 3 above), immediately or gradually establish a liability in the balance sheet and charge it to income.

Following are three simplified examples of the application of the new accounting:

Table 1: Calculating retiree health benefit expense for a new employee,

Table 2: Calculating the expense for a new retiree, and

Table 3: Calculating the expense for an employee that has been with the company for several years.

The first example, a new employee, provides a basic illustration of the methodology. The second, an already retired worker, suggests the relative impact on corporations with a high proportion of retirees to workers, such as steel companies. The third example indicates the relative magnitude of impacts on "young" companies.

In each case, the employee is assumed to have the same career profile:

* Starts employment at age 25,

* Retires at age 65, when he is first eligible to receive retiree health benefits,

* Lives until age 82.

The first section of **Table 1** shows that career graphically. As also shown on Table 1, current retiree health benefit claims are $1,000 (after giving effect to Medicare), estimated to grow 12% per year. A 9% discount rate is assumed. Following the steps outlined above, the calculations are as follows, for a **new employee:**

Table 1

SIMPLIFIED EXAMPLE OF A RETIREE HEALTH CARE PLAN NEW EMPLOYEE

Assumptions:

Employee hired at age 25
Employee will work until age 65
Employee will live until age 82

Eligible for medical benefits if employed by the company when retired.

Current health care claims per retiree, net of Medicare	$1,000
Best estimate of the health care cost trend rate	12%
Discount rate	9%

Employee Career:

25	65	82
Hired	Retires	Dies

1) Projected Trend in Health Care Benefit per year per Employee:

25	65	82
Hired	Retires	Dies
$1,000	$93,000	$640,000

2) Retiree Health Care Benefit Obligation:

25	65	82
Hired	Retires	Dies
$64,874	$2,038,000	$0

3) Retiree Health Care Expense:

25	65	82
Hired	Retires	Dies
$1,768		

4) Retiree Health Care Liability:

25	65	82
Hired	Retires	Dies
$1,768	$2,038,000	$0

Step 1.
Estimate the cost of medical payments to be made, starting in 40 years when the employee retires and continuing for another 17 years during his retirement. In 40 years, growing from the current $1,000 at 12% per year, the annual cost will be about $93,000 in the employee's first year of retirement. In his 17th year, when he should statistically kick the bucket, the annual cost, still rising at 12%, will be $640,000 per year.

In the examples above, health care costs are projected to increase 12% per year forever. This is an unrealistic assumption. While health care costs have been increasing at double digit rates for the past several years, it is unlikely that they will do so indefinitely. In practice, management in conjunction with an actuary, will assume trend rates that reflect the best estimate of health care cost trends over time. For example, management might assume an initial rate based on recent experience and gradually reduce it to an expected ultimate long-term rate.

Step 2.
Compute the present value, **at the date the employee retirees**, of the stream of payments estimated in Step 1. Discounted at 9%, the present value is about $2,038,000. This is essentially the value of the retirement health benefits at retirement date.

Discount the value at retirement date ($2,038,000) to now, that is, the day the new employee starts working. The present value today is $64,874.

Step 3.
To allocate the total present value as expense during the employee's working career, simply do a straight line spread plus interest.

$1,622	Service Cost ($64,874/40)
146	Interest ($1,622 X 9%)
$1,768	Retirement health benefit expense

Step 4.
Since this employee has just started work, there is no liability for benefits earned in prior years.

The company funds on a "pay-as-you-go" basis, so the health care liability recorded on the balance sheet at the end of year one is equal to the first year expense. The liability grows to $2,038,000 at the date of retirement.

To calculate the expense and the liability for a **new retiree**, follow the same steps. Table 2 illustrates the results.

SOUTHERN CALIFORNIA EDISON COMPANY

INVESTIGATION NO. 90-07-037

POST-RETIREMENT BENEFITS OTHER THAN PENSIONS

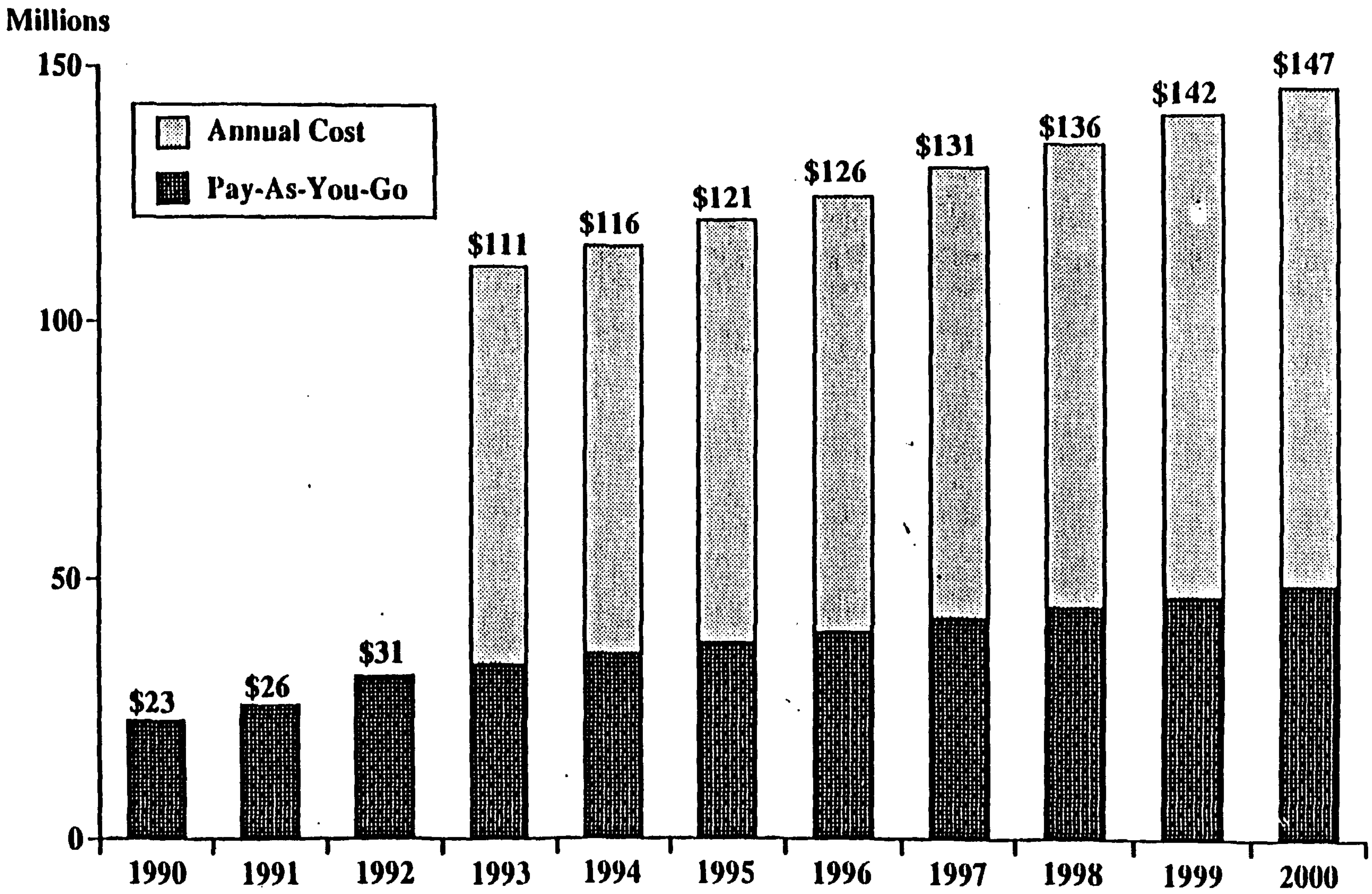
STAFF DATA REQUEST NO. 14

As your company begins (or began, whatever the case may be) to establish pre-funding of PBOPs and as it develops any new policies and procedures to pre-fund its PBOPs obligations pursuant to SFAS No. 106 and Phase I of this OII, please provide the following information:

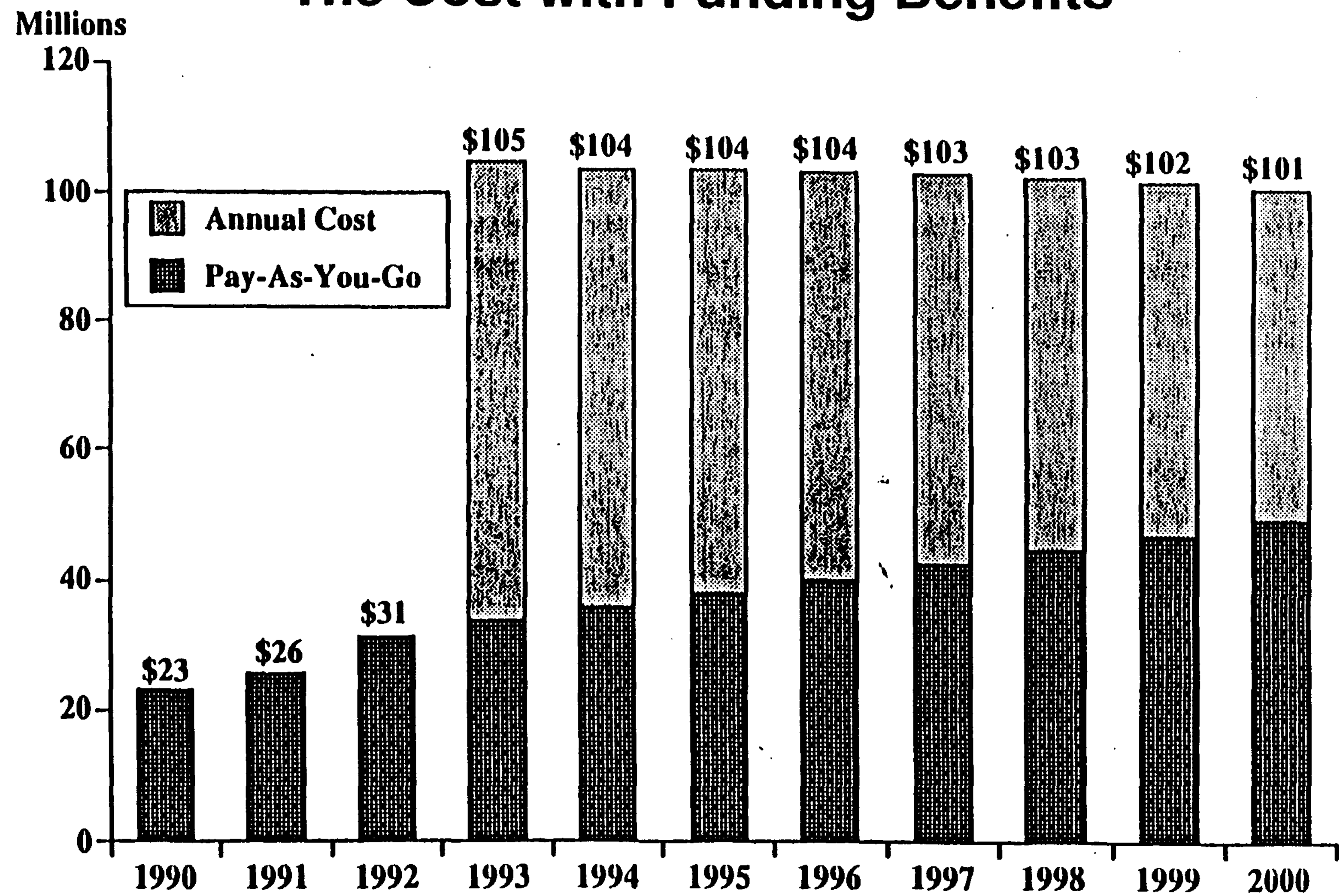
Q. 2 Complete copies of all reports, including executive summaries of studies and/or reports, relating to PBOPs which have been provided to management executives.

A. 2 Please see Attachments 1 and 2 enclosed herein.

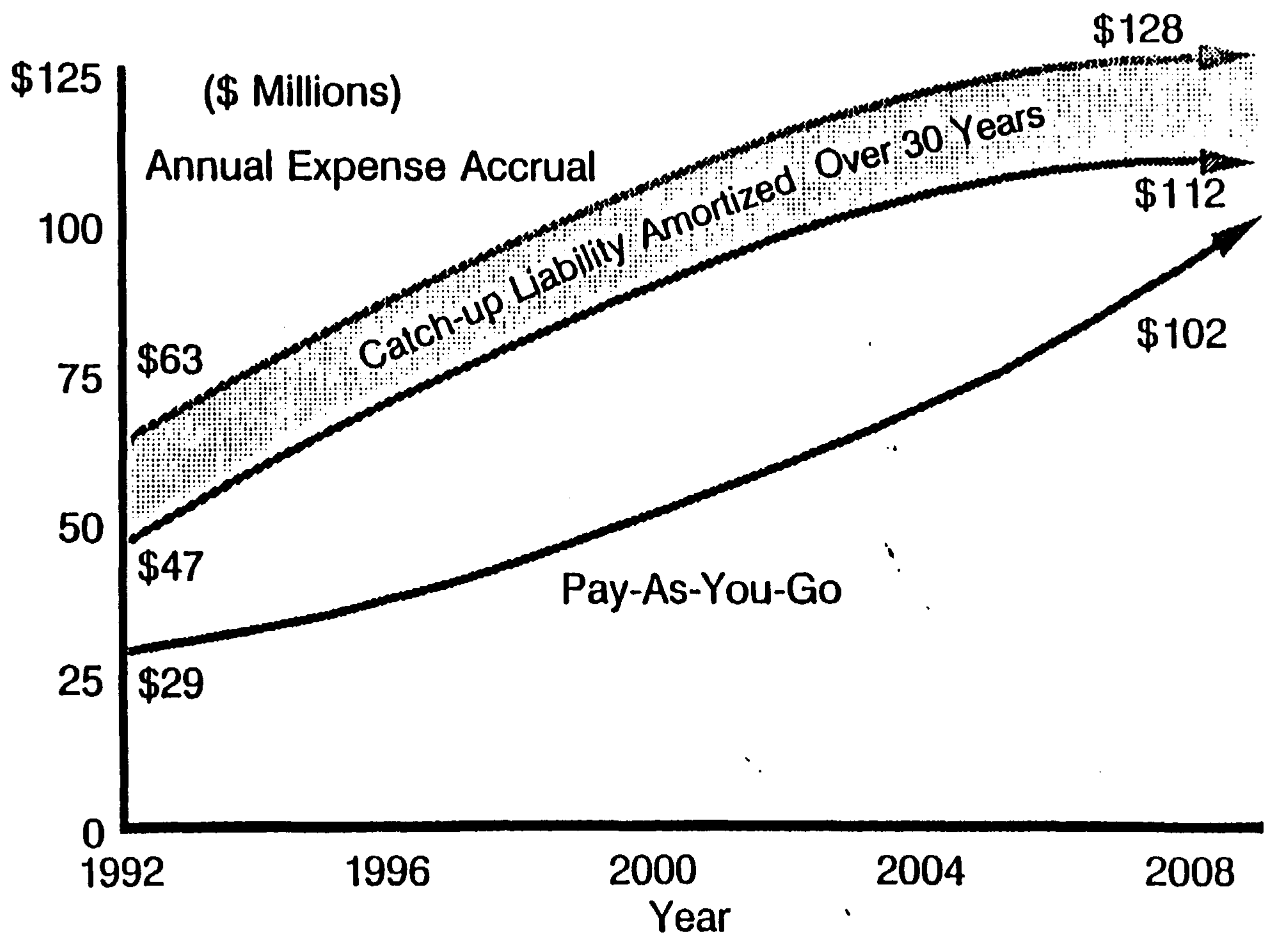
Postretirement Benefits
"The Cost without Funding Benefits"



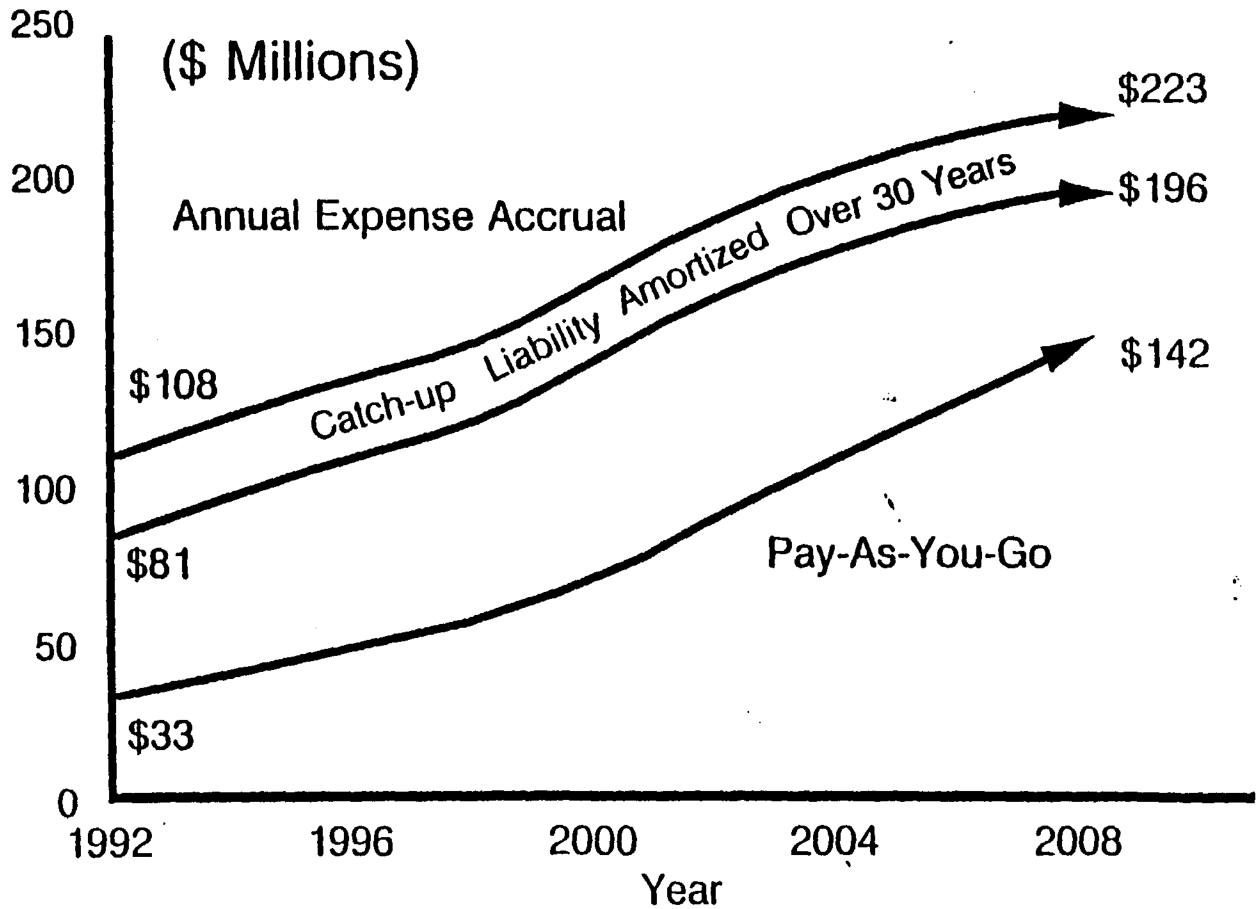
Postretirement Benefits
"The Cost with Funding Benefits"



SCE Post-Retirement Medical Benefit Obligation (Base Case)



SCE
Post-Retirement Medical Benefit Obligation (Mgmt. Case)



SOUTHWEST GAS CORPORATION
OII OF PREFUNDING POSTRETIREMENT BENEFITS
DIVISION OF RATEPAYER ADVOCATES
DATA REQUEST NO. SWG-17

APPLICATION NO: 90-07-037

COMMISSION: CALIFORNIA PUBLIC UTILITIES COMMISSION

DATE OF REQUEST: SEPTEMBER 11, 1991

Request No. 1:

A net present value comparison of prefunding to pay-as-you-go funding. Your response should comprise a long-term time frame sufficient to indicate if and when these two cost streams crossover. Your response must include the same actuarial methods and assumptions as your Phase 2 comments.

Respondent: E. Janov

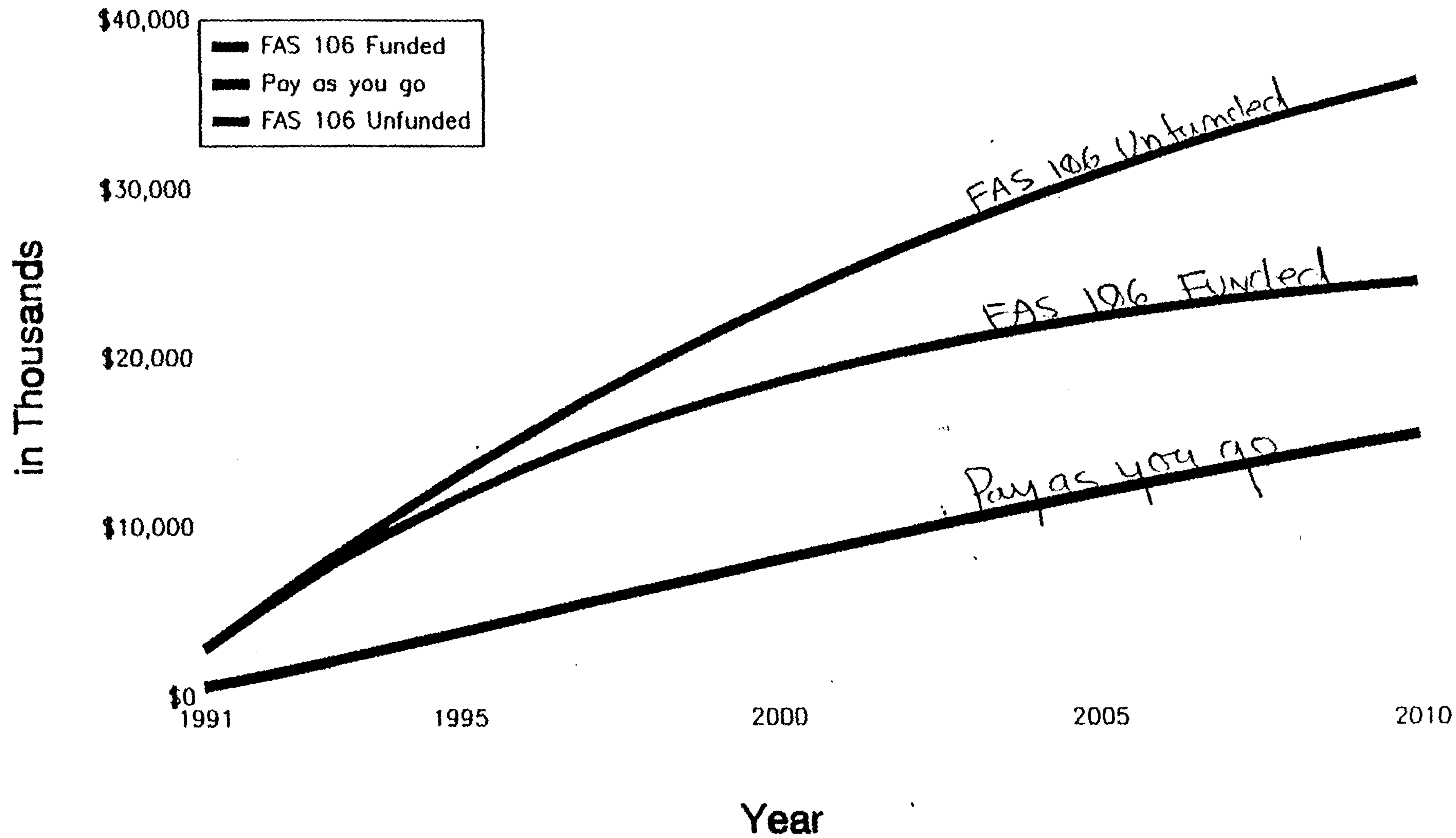
Response:

See attached.

SOUTHWEST GAS CORPORATION

PBOP's

Accumulative Net Present Value



[illegible]SOP's
Net Present Value Comparison
(In Thousands of Dollars)

Year	Funded FAS 106 Cost	8.75% Rate Discounted Amount	Funded FAS 106 Net Present Value	Accumulative FAS 106 Net Present Value	Pay as you go Cost	8.75% Rate Discounted Amount	Pay as you go Net Present Value	Accumulative Pay as you go Net Present Value
1991	$2,849	$0	$2,849	$2,849	$676	$0	$676	$676
1992	2,824	227	2,597	5,446	772	62	710	1,386
1993	2,759	426	2,333	7,779	890	137	753	2,138
1994	2,672	594	2,078	9,856	1,025	228	797	2,935
1995	2,615	745	1,870	11,726	1,171	334	837	3,773
1996	2,560	877	1,683	13,409	1,304	447	857	4,630
1997	2,507	991	1,516	14,924	1,408	557	851	5,481
1998	2,446	1,086	1,360	16,284	1,486	660	826	6,307
1999	2,350	1,149	1,201	17,485	1,652	808	844	7,152
2000	2,284	1,210	1,074	18,559	1,797	952	845	7,996
2001	2,225	1,263	962	19,521	1,927	1,094	833	8,829
2002	2,167	1,306	861	20,382	2,057	1,239	818	9,647
2003	2,077	1,318	759	21,141	2,189	1,389	800	10,447
2004	1,991	1,322	669	21,810	2,313	1,536	777	11,224
2005	1,928	1,332	596	22,406	2,472	1,708	764	11,988
2006	1,864	1,334	530	22,936	2,567	1,838	729	12,717
2007	1,804	1,333	471	23,407	2,721	2,010	711	13,428
2008	1,733	1,317	416	23,823	2,871	2,181	690	14,118
2009	1,604	1,250	354	24,178	3,052	2,378	674	14,792
2010	1,545	1,231	314	24,492	3,204	2,553	651	15,443
Total	$44,804	$20,312	$24,492		$37,554	$22,111	$15,443	

Pay-as-you-go present value	$15,443
FAS 106 present value (funded)	24,492
Difference	($9,048)